Legislative Audit Division

December 1998

Alternatives to Taxation of Light Vehicles

A Report to the 1999 Legislature

Under Chapter 496, Laws of 1997

LEGISLATIVE AUDIT DIVISION

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December 1998

The Legislative Audit Committee
of the Montana State Legislature:

This report is in response to the requirements of Section 39, Chapter 496, Laws of 1997. This section requires the Legislative Audit Committee to conduct an analysis of alternative methods of classification, valuation, and taxation of automobiles and trucks having a manufacturer's rated capacity of one ton or less. The report includes discussion of the current light vehicle tax enacted as part of Chapter 496, Laws of 1997, as well as analysis of costs and benefits of flat fee alternatives and multiple-year licensing.

The flat fee examples included in the report are designed to raise the same amount of revenue currently raised by the two percent ad valorem tax on light vehicles in 1997 on a statewide basis.

We thank the staff of the Department of Justice and the Department of Revenue for their cooperation during preparation of this report.

Sincerely,

Signature on file

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Alternatives to Taxation of Light Vehicles
A Report to the Legislature
Under Chapter 496, Laws of 1997

Section 39, Chapter 496, Laws of 1997 (SB57) states, "The Legislative Audit Committee shall conduct or have conducted an analysis of alternative methods of classification, valuation, and taxation of automobiles and trucks having a manufacturers rated capacity of one ton or less." The section lists six components of the required analysis. These components are:

- alternative methods of valuation and taxation,
- imposition of a flat fee in lieu of taxes,
- multi-year licensing,
- consideration of cost-effectiveness and public convenience of alternatives,
- comparison of costs and revenues of alternative methods, and
- alternative formulae for allocating revenue to counties.

Ad valorem tax information prepared by the Legislative Council staff and the Department of Revenue prior to the 1997 legislative session analyzed methods of valuation and classification for light vehicles in the current value based tax environment. The analysis supported and the legislature enacted in SB57 a four-classification 17-year depreciated Manufacturers' Suggested Retail Price (MSRP) schedule as a basis for determining value on which the existing ad valorem taxes are levied. The legislation did not change the two percent tax rate on vehicle value and retained the local option one-half percent tax. The analysis completed by the council and the department predicted limited tax shifts between counties. By using depreciated MSRP as the basis for vehicle value, market price fluctuations and dealer reporting of sales price do not generate discrepancies between vehicles of the same make and model. The analysis discussed the increase between tax paid for new vehicles and tax paid in the second and third years caused by the lower rate of the new car tax. In the analysis, the tax increase in years two and three was higher for some vehicle classifications where MSRP more closely follows vehicle value. If the legislature wants to retain a value based vehicle tax, then SB57 has enacted such a system.

Taxpayers continue to voice concerns about light vehicle taxes. In addition to paying higher taxes in the second and third year than for the year in which the vehicle is new, differences in how vehicles within classifications hold market value cause some vehicles to have a higher depreciated MSRP value than market value. The consistency of the valuation within vehicle type, such as passenger cars, can generate variations for specific makes which do not fall close to the average depreciation for the vehicle type. Although the SB57 system values each make and model with MSRP, fluctuations in market value between individual units of the same make and model, caused by factors such as mileage and condition, can cause noticeable discrepancies between the market and depreciated MSRP value. Since 1998 was the first year of SB57 implementation, some taxpayer concerns reflect transition to the MSRP system rather than flaws in system design. When Montana changed from blue book to depreciated MSRP, some vehicle values increased, even though the vehicles were older. Under the depreciated MSRP system, such increases will not occur in subsequent years unless the law is changed.

FLAT FEE

A flat fee approach could simplify the tax structure by making individual taxes more predictable and easier to understand. A flat fee system limits increases of motor vehicle fee revenues unless the fee is raised, except for growth in the number of vehicles. Since light vehicles are the only group of vehicles which do not pay a flat fee in lieu of tax, a flat fee would be consistent with other vehicle types. For these reasons, the legislature requested further study of the flat fee option when it adopted SB57.

Current law distributes the two percent tax on light vehicles in the same proportions as levies on property in the taxing district of the owner. With such a distribution, the light vehicle tax is a general revenue source for state equalization of schools, for counties, cities and school districts, and for other local government functions. Using data from the Department of Justice computer files on light cars and trucks, we calculated vehicle owners paid approximately $73,666,300 in light vehicle two percent taxes in 1997. Based on state accounting records, we estimated collections of the one and a half percent new car sales tax of $10,500,400 for the same period.

The light vehicle tax and the new car tax are distributed differently. Under section 61-3-509, MCA, seven percent of light vehicle taxes go to defray costs of district court operations and the remaining amounts are distributed from the motor vehicle suspense fund in the relative proportions required by the levies for state, county school district, and municipal purposes in the same manner as personal property taxes are distributed. Section 61-3-502(6), MCA, directs that the county treasurer retain five percent of the new car tax to pay the costs of collection and remit the remaining collections to the state for deposit in the highway nonrestricted account. A dollar of the tax on each new vehicle is allocated to the Department of Commerce to administer motor vehicle warranty laws.

FLAT FEE MODELS

We developed several flat fee models. For the first, we conducted a computerized count of registered vehicles which paid the two percent tax. After completing the count of registered vehicles, we calculated the single whole dollar fee which would raise the same revenue as the taxes raised in 1997. In calculating the estimate, we assumed no changes in laws governing prorating the fees and we assumed the vehicles exempt from the ad valorem tax would be exempt from the fee. We calculated the number of vehicles for which the fee would have been higher than the tax paid in 1997, the number of vehicles for which the fee would have been equal to or lower than the tax paid in 1997, and the average amount by which the fee exceeded or was lower than the tax. The results, rounded to the nearest dollar, are shown in the following table.

Motor Vehicle Fee in Lieu of Tax	
Number of light vehicles for which 2 percent tax was paid in 1997.	747,231
Flat fee replacement for 2 percent tax.	$99
Number of light vehicles which would pay higher fee.	478,524
Average amount of additional fee.	$68
Number of light vehicles which would pay lower fee.	268,707
Average amount of fee reduction	$119
Source: Legislative Audit Division	

The second model has two fee levels. The first fee tier covers the 1994-98 model years. The second fee level applies to model years 1993 and earlier. As with the single fee model, we calculated the number of vehicles for which the fee would have been higher than the tax paid in 1997, the number of vehicles for which the fee would have been equal to or lower than the tax paid in 1997, and the average amount by which the fee exceeded or was lower than the tax. The results are rounded to the nearest dollar and shown in the following table.

Motor Vehicle Fee in Lieu of Tax-Two Fee Levels	
Number of light vehicles for which 2 percent tax was paid in 1997 with model years 1994-98.	116,396
Flat fee replacement for 2 percent tax, model years 1994-98.	$300
Number of light vehicles for which 2 percent tax was paid in 1997 with model years 1993 or earlier.	630,835
Flat fee replacement for 2 percent tax, model years 1993 and earlier.	$61
Number of light vehicles which would pay higher fee.	474,072
Average amount of additional fee.	$46
Number of light vehicles which would pay lower fee.	273,159
Average amount of fee reduction	$80
Source: Legislative Audit Division	

In comparison to the single fee model, the two fee model has smaller averages for the higher and lower fees paid in relation to the two percent tax.

INCOME TAX DEDUCTIBILITY

Flat fees would not be deductible for federal tax purposes. The Department of Revenue's Tax Policy and Research Group estimated annual increases of $3.8 million and $1.8 million in federal and state income tax liability if a flat fee system replaced the current tax for light vehicles. The department used calendar year 1996 data in the simulation program and compared the 1997 estimates to those generated with the two

percent tax in place. The $1.8 million increase in state income tax includes the effects of deducting the increase in federal income taxes. If state law were changed to allow deduction of the fee on state returns, the department estimates the income tax decrease on state returns caused by deduction of the increased federal tax paid to be $356,000. The incidence of this decrease by income level is shown in the table below. Decile level 10 includes those with the highest income and level zero includes those who were not required to file income tax returns.

Impact of Federal Income Tax Increase on Montana Income Tax Liability Due to a Flat Fee on Light Vehicles				
Decile	**Number of Households**	**Current Law MT Liability Calendar Year 97**	**Federal Effect MT Liability Calendar Year 97**	**Difference**
0	4,687	$ 658	$ 658	$ 0
1	34,553	50,060	50,060	0
2	35,643	1,353,046	1,353,046	0
3	35,534	3,447,768	3,447,724	(44)
4	34,678	6,252,566	6,252,244	(322)
5	37,372	11,284,975	11,283,142	(1,834)
6	35,809	18,711,368	18,704,946	(6,422)
7	35,471	29,483,781	29,468,524	(15,257)
8	34,855	43,579,241	43,547,093	(32,148)
9	35,854	67,747,927	67,670,040	(77,887)
10	35,765	185,218,481	184,996,457	(222,024)
Total	360,221	$ 367,129,871	$ 366,773,933	$ (355,937)
Source: Department of Revenue, Tax Policy and Research Process Group				

FLAT FEES IN OTHER STATES

Twenty states have no value based tax on motor vehicles. Of these twenty, five are located west of the Mississippi. Idaho, New Mexico, North Dakota, Oregon, and South Dakota all have large sparsely populated areas and several counties with larger cities and heavier population concentrations. In this respect, these states are similar to Montana.

Vehicle registration fees range from $20 in South Dakota and New Mexico to $49 in North Dakota. Of the five states, four have annual vehicle registration. Oregon has two year registration and allows the registration fee to be transferred to a new owner. The new owner pays a $6 transfer fee and acquires the remaining paid time period on the registration. The states which have annual registration offer a reduced fee for older vehicles. For example, North Dakota lowers the fee to $41 for a car that is 6 to 9 years old, to $33 for 10 to 12 year old cars, and $25 for cars 13 years and older.

In each of the five states, the money raised by the fees is allocated to highway and road funds. Idaho, North Dakota, and Oregon deposit registration fees in state highway accounts. New Mexico splits fees 50/50 between the state road fund and counties in proportion to the mileage maintained by each county as a percentage of mileage maintained by all counties in the state. In South Dakota, registration fees are deposited in the county road fund. None of these states use motor vehicle fees as a general revenue source as Montana does with the current two percent tax. The following table summarizes the comparative data.

State	Registration Fee	Years	Plates	Property Tax-Vehicle
Idaho	$ *48	1	Stay w/ seller	No
New Mexico	$ ** 20	1	Stay w/ seller	No
North Dakota	$ • 49	1	Stay w/ car	No
Oregon	$ 30	2	Stay w/ car	No
South Dakota	$ •• 20	1	Stay w/ car	No

* Vehicles: 1 & 2 years old $48
3 & 4 years old $36
5 & older $24

** After 5 years $16

• Years 6 - 9 $41
Years 10 - 12 $33
Years 13 and older $25

•• Fee reduced 30% when car is 5 years or older.

Source: Compiled by the Legislative Audit Division.

MULTI-YEAR LICENSING

The ad valorem tax system adopted in SB57 did not address multi-year licensing. With a flat fee, the convenience of multi-year licensing could be more easily offered to vehicle owners. Of the 20 states which do not have value based taxation of light vehicles, four of them have multi-year licensing. Three of these four have a two year license and one, Delaware, offers a choice between six-month, one-, two-,

and three-year registration. Only Oregon allows fee proration for ownership transfer. In the other states, the fee is paid at each registration.

With a non-transferable fee, each registration could run one or more years from the date of registration. Fewer registrations would be required, thereby cutting administrative costs and promoting taxpayer convenience. Since a new registration sticker is issued at each registration, this would not involve a significant change in registration procedure. Department of Justice Motor Vehicle Division personnel said multiple-year options, such as those offered by Delaware, would incur costs to implement since each option would have to be programmed into the system.

PERPETUAL LICENSING

One option which could offer convenience to the public is a perpetual license. For certain older vehicles, owners could pay a one time fee, registering the vehicle for as long as they own it. The fee would be set based on the average remaining useful life of a vehicle at the age for which the option is offered. The fee necessary to attain revenue neutrality for the older vehicles would also be adjusted for the expected transfers of such vehicles. Based on 1997 registrations, we found vehicles 17 years and older transferred at a rate of 9.45 percent of the total in the population. With only one year of data, we could not estimate the percentage of older vehicles taken out of service each year. A perpetual licensing option could be added to either the current system or the flat fee system.

FEE CONSOLIDATION

Consolidation of incidental fees paid at registration could simplify accounting at both state and county levels by reducing the number of accounts. To maximize the convenience to the public, payment of incidental fees would be for the same time period as the flat fee. Under current law, counties collect the fees listed below for the state when a vehicle is reregistered.

- state registration, $5
- weed fee, $1.50
- computer fee, $1
- junk vehicle fee, $.50
- highway patrol fee, $.25

At the time of transfer, when an owner titles and registers a vehicle for the first time, a junk vehicle fee of $1.50 is collected. In addition, gross vehicle weight (GVW) fees are collected on truck registrations. Some of these incidental fees, such as GVW and weed fees, have a county administrative share. Consolidation of these fees would decrease the county accounting effort on behalf of the state and reduce state data input costs. However, actual savings to counties would be negligible because many county accounting systems interface with the motor vehicle system and make the distributions required by current law electronically. Consolidation of incidental fees would necessitate programming changes in county computer systems.

OTHER POLICY ISSUES

In analyzing the feasibility of a flat fee system, the legislature will consider the following issues of revenue distribution, prorating fees, and exemptions. The legislature may also consider replacement of the new car tax.

Revenue Distribution

In analyzing revenue neutrality, the legislature should consider total revenue raised statewide by the fee, revenue raised within each county for distribution to local governments, and revenue raised within each taxing district. Establishing flat fee amounts to achieve neutrality in total revenue and approximate neutrality by taxing district could require a system of fees as complicated as the current system. Another method of distributing revenue would use the MSRP data captured at registration to maintain the current taxing district share of the fee. Under this alternative, each county would keep as its share of the motor vehicle fee its pro rata share of the MSRP of light vehicles registered during the year. The taxing district shares would be allocated in the same way as under current law. Such an approach would also tend to allocate growth in fee revenue to the localities where vehicle numbers and values have increased.

Taxpayer Equalization

In designing a flat fee for light vehicles, the legislature should consider the impact on individual vehicle fees paid. A provision called a "grandfather clause" could be included in the flat fee legislation to ensure current owners do not incur a higher fee on vehicles currently owned. The fee limit would not apply to vehicles purchased after the effective date. With a "grandfather clause," the legislature would have to provide revenue from a source other than the fee to maintain revenue neutrality to taxing jurisdictions.

Prorating Fees

Under current law, the vehicle retains its anniversary date for payment of the two percent tax at the time of ownership transfer. The tax is only paid on the anniversary date. Other incidental fees are paid each time the vehicle is registered. If a flat fee were paid each time a vehicle is registered, the number of fee payments increase and the fee necessary to maintain revenue at the same level raised by the current two percent tax on a statewide basis decreases. If the fee were paid each time a vehicle is registered, a single fee amount of $90 would have raised the same revenue as the two percent tax in 1997.

Exemptions

In addition to registered vehicles on which the current two percent tax or new car tax was paid, we counted 25,916 light vehicles exempt from taxation. Many of these exemptions result from property tax exclusions for certain owners. Property tax exclusions would not exempt the owners from paying a motor vehicle fee. Whether an exemption from the current motor vehicle ad valorem tax would be extended to a fee is a policy matter for consideration by the legislature. The exemption category description and number of exemptions in each category appear in the following table.

Exemptions from 2% Light Vehicle Tax - 1997		
	Exempt Status	**Number of Vehicles**
VE	Disabled Veteran	1,093
TR	Tribal	17,730
PW	Potable Water Co-op	11
MM	Montana Military	1,720
MI	Non-Resident Military	4,258
ID	Irrigation District	3
HO	Hospital	191
GV	Government (Fed, State, County)	84
ED	Educational	256
DD	Developmentally Disabled	138
CO	Charitable Organization	425
CD	Cemetery District	7
	TOTAL	25,916
Source: Compiled by the Legislative Audit Division		

New Car Tax

One of the features of current motor vehicle tax law which concerns the public is the increase in light vehicle tax paid in the second year as compared to the new car tax. As long as state law sets the new car tax at one and a half percent and the ad valorem tax at two percent, this issue will persist. A flat fee applied to all light vehicle model years as replacement for the current new car tax could eliminate the increase in vehicle taxes in the second year. For the single fee, we calculated that a fee of $108 would replace both two percent ad valorem and new car tax for 1997 vehicles which paid these taxes. This single fee is nine dollars higher than the $99 level necessary to replace the revenue of the two percent tax on light vehicles.

CONCLUSIONS

SB57 enacted ad valorem taxation of light vehicles based on MSRP. Other than the cost of loading the MSRP data each year, this system has similar operating costs to flat fee systems. Once the MSRP data for a model year is in the system, the tax for that vehicle for any year of its life can be calculated. Therefore, the MSRP system could handle multi-year licensing option, generate tax bills for future years, and be amended to allow imposition of a single replacement fee for all the current incidental

fees, in addition to the two percent tax, assessed on light vehicles. If the legislature wants light vehicle taxation to reflect value, the state has a reasonable system.

A flat fee system for taxation of light vehicles provides predictability of tax for vehicle owners, an averaging of the tax by vehicle rather than distribution based on value, more opportunities to simplify the registration process over the long term, and consistency with other vehicle types which use a flat fee.

If the legislature were to adopt a flat fee system, legislators would need to consider several related issues. First, the flat fees would not be deductible for federal tax purposes. Second, almost any flat fee system will cause costs to shift to older vehicles. Third, the tax base does not tend to expand with rising new car prices, effectively capping light vehicle levies as a revenue source. Fourth, redistribution of revenue would be required to achieve revenue neutrality at the county level and maintain current overall revenue levels.

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